No. 9469.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

ARMATURE EXCHANGE, INCORPORATED, a corporation, also known as THE ARMATURE EXCHANGE, a corporation, also known as THE ARMATURE EXCHANGE, INCORPORATED, a corporation,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

BRIEF FOR THE UNITED STATES.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
NORMAN D. KELLER,
GEO. H. ZEUTZIUS,
CARL PERGLER,
Special Assistants to the Attorney General.

BEN HARRISON,
United States Attorney.
E. H. MITCHELL,
Assistant United States Attorney.
ARMOND MONROE JEWELL,
Assistant United States Attorney.

United States Postoffice and Courthouse Building, Los Angeles, California,

Parker & Baird Company, Law Printers, Los Angeles.

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES. PAGE

STATUTE.

MISCELLANEOUS.

No. 9469.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

ARMATURE EXCHANGE, INCORPORATED, a corporation, also known as THE ARMATURE EXCHANGE, a corporation, also known as THE ARMATURE EXCHANGE, INCORPORATED, a corporation,

Appellee.

BRIEF FOR THE UNITED STATES.

Opinion Below.

The opinion of the District Court [R. 11] is reported in 28 F. Supp. 10.

Jurisdiction.

This is an appeal from a judgment of the District Court entered September 13, 1939 [R. 41], in the amount of $1,452.30, without interest, assessed and paid as manufacturer's excise taxes. Notice of appeal was filed December 12, 1939. [R. 42-43.] The jurisdiction of this Court is invoked under Section 128(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Whether *sales* of automobile armatures by appellee were taxable under the statute imposing tax upon automobile parts, "sold by the manufacturer, producer, or importer" thereof.

Statute and Regulations Involved.

The applicable statute and regulations will be found in the Appendix, *infra,* pages 31-32.

Statement.

The case was tried to the Court without a jury, and the evidence consisted of the testimony of three witnesses for appellee, together with numerous exhibits and documentary evidence adduced by each of the parties. After oral argument the Court rendered an oral opinion [R. 11-26], and subsequently filed findings of fact and conclusions of law in favor of appellee. [R. 28-40.] The facts, as disclosed by the undisputed evidence, may be summarized as follows:

Appellee was incorporated under the laws of California [R. 28] "to carry on the business of manufacturing and assembling armatures, motors and electrical equipment of any and all kinds. To design and prepare plans and specifications for the manufacture, construction and assembling of electrical appliances and equipment. To enter into contracts and make the necessary agreements for marketing and disposing of the same * * *." [R. 106.]

The following is a summary of appellee's major processes and operations in the production of armatures by combining new materials with usable parts salvaged from used and worn out armatures:

The used and worn out armatures were placed in a lathe and the wires leading from the core to the commutator were cut out with a knife as the lathe revolved. (Joint Ex. No. 1, p. 1.)

The cores were then heated over a gas flame for about 20 minutes (the flames coming up from a range within the metal box shown in Joint Exhibit No. 1, p. 2). The purpose of the heating was to loosen the old wires and old insulation so that they might be easily removed. (Joint Ex. No. 1, p. 2.)

After the units were laid out on a metal top table and slightly cooled, they were placed in a V-shaped slot, and a steel chisel was driven down between the mass of old wires which had been loosened by heating, and the old wires were pried out. (Joint Ex. No. 1, p. 3.)

The stripped units were then placed in a machine equipped with a small saw that reslotted each commutator bar at the place where the old wires were soldered in (*i. e.*, at the end of the commutator closest to the core). This machine was operated by suspending the shaft on which the core and commutator were mounted between a clamp, and the saw-blade about one and one-half inches in diameter was moved up to each slot by means of a lever, and the shaft was rotated by hand. Any solder remaining in the slots was removed with a small metal pick. (Joint Ex. No. 1, p. 4.)

The placement of the commutator on the shaft was checked with a pair of calipers by measuring from the point on the shaft where the bearing rode to the front end of the commutators. The distance from the core to the commutator was measured with a metal rule. (Joint Ex. No. 1, p. 5.)

Any errors in the mounting of the core or commutator on the shaft were corrected by means of adjusting their respective placements by means of an arbor press. The laminations of almost every core were pressured together on this same press before any further steps were taken. This latter operation was done to realign any laminations which might have become somewhat separated. (Joint Ex. No. 1, p. 6.)

A test was given to insure that none of the bars on the commutator were grounded to the shaft, or shorted. This was done by rotating the end of a live wire over the commutator, and at the same time having the shaft grounded. (Joint Ex. No. 1, p. 7.)

Then each portion of the shaft leading from each side of the core was insulated by approximately five wrappings of paper around the shaft as it protruded from each end of the core. The insulation was about an inch or so in length. Each slot in the core was also insulated by placing therein a folded insulating paper approximately the size of a cigarette paper; and each surface end of the core was insulated with a heavy pressed cardboard which had been stamp-cut the shape of the surface ending of the core. This is illustrated in Joint Ex. No. 1, p. 8, in which all three types of insulation are shown. (Joint Ex. No. 1, p. 8.)

Approximately 95% of the armatures were wound on a Chapman winder, designed to wind armatures with fourteen-slot cores. Those which had a different number of slots had to be wound by hand. This machine had a lathe, in which were two jaws that held the laminated core in such a manner that the shaft extended perpendicularly from the axis of the lathe an equal distance in each direction. Two strands of wire led from two different reels

up through the top of the machine, over pulleys and down to the armature in the jaws of the lathe. Two sizes of wire (Nos. 16 and 17) were used in the winding, depending upon the electrical output expected out of the generator; *i. e.,* a heavier wire can give a greater output. Each coil was wound with six complete turns. On each turn, the wire in the slot on one side of the core led into the slot on the direct opposite side of the core. There were two coils in each slot, making, therefore, in the case of a fourteen-slot core, twenty-eight coils. Upon the completion of each coil, that is, after six turns, the wire was laid up over the commutator-end of the shaft, and, at the conclusion of the next coil following, that particular wire was cut near the commutator-end of the shaft and the lead end of the wire folded back. However, the lead ends on the top coils of the half of the core that was lastly wound were not cut by the winder operator, because there was no necessity of cutting them, but they were left suspended in a loop over the commutator end of the shaft. The only reason for cutting the other wires was because they were from coils that were underneath and, if they were not cut, the wire from the top coil would bind them down to the shaft. (Joint Ex. No. 1, p. 9.)

The armature was then placed in a lathe-like clamp, called a bench center, which clamp suspended the armature by holding it at each end of the shaft. Then all of the wires which were not previously cut by the operator on the winding machine were cut, and this left fifty-six leads, with two leads to each coil, and two coils to each slot. Wooden wedges were then driven over the top of the wires and into each slot of the laminated core, as shown in Joint Ex. No. 1, p. 10. This was for the purpose of holding the wires in the slots. (Joint Ex. No. 1, p. 10.)

The leads were pulled down in three equal groups and the ends of the leads inserted into an electrically driven machine with two wire rollers operating in opposite directions, which cleaned all of the insulation from the leads for a distance of about two inches from the ends of the leads. These leads extended approximately four inches out of the slots of the core. (Joint Ex. No. 1, p. 11.)

The leads from the top coils were folded back over the core, and then the leads from the bottom coils were similarly folded back. This was only for the purpose of making them easily available to the operator when he was connecting them with the commutator. There were four sets of leads, corresponding with the sets of coils in the armature. These leads were inserted firmly in place by means of a small chisel. As the leads were connected, the operator rotated the armature. A connection of a set of leads was completed with each rotation. As each complete rotation was made, the wires which then lead from the core to the commutator were insulated by wrapping with insulating paper approximately one and one-half inches in width. Since there were four complete sets of leads, this made three sets of insulation, the top leads being exposed. Twine was then wrapped around just behind the commutator with about seven turns so in the event the soldering holding the leads into the commutator became hot, the cord would still keep the leads in place. (Joint Ex. No. 1, p. 11.)

Solder flux was painted around the commutator where the wires had been tapped into the slots. The whole com-

mutator was then immersed into solder, the solder only adhering to the band where the flux had been applied. (Joint Ex. No. 1, p. 12.)

The armatures were then placed on end in a tray, and the tray was lowered into an insulating varnish, where it remained for about 15 or 20 minutes, so that the cotton insulation of the wire would be completely saturated. The tray was then raised, and the armatures drained for approximately 30 minutes. (Joint Ex. No. 1, p. 13.)

The armatures were placed in an electric oven and baked overnight at a temperature of about two hundred and fifty degrees. The total day's production was generally dipped and baked at one time. (Joint Ex. No. 1, p. 14.)

The armature was taken from the oven and placed in a lathe where the commutator was planed down sufficiently to true the brush surface of the commutator. (Joint Ex. No. 1, p. 15.)

The end of the shaft of the armature was placed in a chuck and was rotated, and by applying an abrasive cloth to the surface of the laminated core, the shaft and the commutator, the same were polished, and all the excess varnish was removed from the metal. (Joint Ex. No. 1, p. 16.)

The armature was then placed between centers and a small saw blade, approximately one-quarter inch in diameter, cut the level of the mica insulation between the commutator bars to a level below that of the surface of the bars of the commutator. (Joint Ex. No. 1, p. 17.)

The armature was tested for shorts. This was done by placing the armature onto a magnetic growler (that is, by setting the core part on the magnet) and if there was a short in the armature, a thin metal blade would be attracted to the core, as shown in Joint Ex. No. 1, p. 18.

The armature was tested to see if it was grounded by touching one wire to the shaft and the other to the commutator, and if it was grounded, the connection was made and a light attachment was illuminated. (Joint Ex. No. 1, p. 19.)

The shafts were then checked for undersize with a micrometer. If the shaft was too far undersize, it had to be knurled or sleeved. The process of knurling is illustrated in Joint Ex. No. 1, p. 20. The shaft was roughened so that it would fit snugly with a bearing. If the shaft was too small to be knurled, it had to be turned down on a lathe and a metal sleeve driven over it. About fifty per cent of the shafts had to be knurled, and about fifteen per cent had to be sleeved. (Joint Ex. No. 1, p. 20.)

The armatures were then finally checked by rotating the commutators under a micrometer. This was done for the purpose of insuring that every bar of the commutator was of approximately the same height, otherwise proper contact with the generator brushes would not be made. This test is illustrated in the picture on the left side of Joint Ex. No. 1, p. 21. The ends of the shafts were then rethreaded and the armatures were ready for boxing. (Joint Ex. No. 1, p. 21.)

One of the final steps consisted in stamping appellee's trade-name "Armex" into the laminated core. [R. 102.]

Thereafter the same were separately boxed and labelled, as shown by photographic exhibit No. 14. [R. 77.] The armatures were sold by appellee mostly to jobbers on the exchange basis of sale for replacement parts, that is, the selling price was paid partly in cash and partly by an allowance made for a used article taken in trade. The appellee's catalog list prices ranged from $2.50 to $22.50. [R. 82, 95.] The catalog prices were subject to jobbers' discount. [R. 93.] If a sale was made to a customer who did not bring in an old armature, an added charge was made of from 50¢ to $1. [R. 95.] The appellee also purchased worn out armatures from junk men for use in its operations. [R. 95, 97.] Usually about 3,000 armatures were on hand in all of the various stages, of which 1,000 armatures were in complete form and ready for sale. [R. 80.] The 1,000 articles represented about 600 different types of armatures. [R. 81.] Sales transactions involved from one to as many as 40 or 50 armatures. [R. 82.]

Approximately 14 or 15 men were employed in appellee's armature operations and about 80 armatures were turned out, checked, boxed and put on the shelves daily. [R. 83.] The armatures so produced by appellee were merchantable and quality products and so represented. They were sold by leading jobbers under appellee's own trade name and catalog code number and were guaranteed as to quality. [R. 60, 62, 64, 77, 104.]

In its advertising matter published during 1932, 1933, and 1935 [Pltf's Exs. 3, 4, 5, R. 60, 62, 64] the appellee constantly and conspicuously used the trade-name "Armex" for its products. In Exhibits 3 and 4 [R. 60, 62] there is a heading "Product of the Armature Exchange, Inc.", and the phrase "Guaranteed Quality" is also used.

The appellee, having been informed by the Collector of Internal Revenue that it was liable for excise tax on the sale of its armatures, filed excise tax returns for the period June, 1935, to and including December, 1936, showing an aggregate tax due of $1,052.30 which was paid. [R. 3-4.]

On September 6, 1935, the Commissioner assessed the sum of $1,579.72 against the appellee to cover delinquent tax and interest on the sale of automobile generator armatures which were sold during the period from June, 1932, to May, 1935, inclusive, and the appellee has paid the sum of $400 on that tax, in eight installments of $50 each, from May 28, 1936, to December 30, 1936. [R. 4-5.]

On April 29, 1937, the appellee filed a claim for the refund of $1,452.30. [R. 5.] The claim is predicated on the ground that the appellee was neither the manufacturer nor producer of the armatures, but that its process constituted the repair, rebuilding or rewinding of damaged and burned out automobile generator armatures; also that the burden of the taxes was borne by appellee. [R. 6-7.] On November 18, 1937, the Commissioner of Internal Revenue rejected the appellee's claim. [R. 8.]

Statement of Points to Be Urged.

The points to be urged by the appellant are fully set forth in the record [111-112], and are fully relied upon here. The main point is that the District Court erred in determining that the sales of armatures by the appellee, during the taxable period involved herein, were not sales of automobile parts or accessories by a manufacturer or producer within the purview of Section 606(c) of the Revenue Act of 1932.

Summary of Argument.

The transactions involved constituted sales of automobile parts within the meaning of the statute, which is a revenue measure exclusively, and is to be construed accordingly. The automobile parts were fashioned by combining new materials with salvaged materials and subjecting them to numerous machine and hand operations which clearly constituted manufacturing processes. The completed articles were stocked, cartoned, labeled, cataloged and marketed by appellee under its own trade mark and trade name "Armex" and were sold chiefly to jobbers for resale to garage men and mechanics for use in repairing automobile motors for individual car owners. From the standpoint of production and distribution in the trade, appellee performed the function of a manufacturer and producer of armatures in the true sense and not the repairing of used armatures for owners or users.

The principles of the better reasoned and more recent decisions support the view that appellee is a manufacturer or producer of automobile parts. Likewise, under the applicable Treasury Regulations the appellee is taxable as the manufacturer or producer of the articles it sold.

The judgment, ultimate findings and conclusions of the court below are not supported by the evidence, are erroneous, and should be reversed.

ARGUMENT.

I.

The Transactions Involved Constituted Sales of Automobile Parts Within the Meaning of the Statute, Which Is a Revenue Measure Exclusively, and Is to Be Construed Accordingly.

By Section 606(c) of the Revenue Act of 1932 [Appendix, *infra*], an excise tax equivalent to 2% of the sales price is imposed with respect to automobile parts or accessories upon the manufacturer, producer, or importer thereof. However, no imports are involved here.

Clearly, the "Armex" armatures sold by appellee are automobile parts or accessories. Thus, the inquiry is whether appellee's sales thereof are taxable to it as the manufacturer or producer within the meaning of the Act. The court predicated his decision against the Government upon the view that the mechanical operations of the appellee constituted merely a process of repair and restoration and that, therefore, appellee was not a maufacturer or producer within the provisions of the statute. We submit that the decision is erroneous.

We contend that appellee was engaged in the manufacture, production and sale of armatures and not in the business of repairing used and worn-out armatures; that it had a factory, made armatures and sold them—it did not enter into contracts for the performance of labor and supplying of material with respect to articles owned by others who retained ownership and sought merely to prolong the life thereof by having the articles repaired for their own use; that in connection with the production of its article, appellee purchased used, burned out and worn out armatures which had been discarded and relegated to the junk heap, *i. e.,* it used, in part, scrap having a value

essentially as raw material; that it stripped and dismantled the used and discarded armatures and salvaged and prepared the usable shafts, commutators and laminated cores for its manufacturing and production processes; that by machine and hand operations, lathing, cleaning, polishing, cutting, manipulating, assembling, baking, adding and combining with the prepared salvaged parts new materials and industry, it processed and fashioned such materials into articles of merchandise which it stocked and marketed under its own special trade name "Armex" quality armatures; that all of such articles were the equivalent of armatures processed and fabricated entirely from new materials which had not been previously used in similar manufactured articles. In other words, we contend that all of the essential elements of manufacture exist for the purpose of the taxing statute.

The statute is very broad and comprehensive and indicates a Congressional intent to bring within the reach of its taxing provisions all persons placing automobile parts and accessories on the market for sale in the United States.

An example of the broad scope of the tax, as intended by Congress, is furnished by Section 623 of the Revenue Act of 1932, which provides:

> SEC. 623. SALES BY OTHERS THAN MANUFACTURER, PRODUCER, OR IMPORTER.
>
> In case any person acquires from the manufacturer, producer, or importer of an article, by operation of *law or as a result of any transaction not taxable under this title,* the right to sell such article, the sale of such article by such person shall be taxable under this title as if made by the manufacturer, producer, or importer, and such person shall be liable for the tax. (Italics supplied.)

The applicable Treasury Regulations (Regulations 46) broadly define the terms used in the Act. They provide in part as follows:

> ART. 4. *Who is a manufacturer or producer.*—As used in the Act, the term "producer" includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.
>
> Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.
>
> * * * * * * * *
>
> ART. 41. *Definition of parts or accessories*—The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article * * *.

Section 1111(b) of the Revenue Act of 1932 provides that the term "includes" when used in a definition in the Act shall not be deemed to exclude other things otherwise within the meaning of the term defined, and Article 2 of Treasury Regulations 46 provides that the "terms used in these regulations have the meaning assigned to them by section 1111."

Thus, it is obvious that Congress intended to impose the tax upon the sale of each and every automobile part or accessory produced and sold to wholesalers, jobbers and

distributors as well as sales by the manufacturer directly to the retailer or ultimate consumer. However, the decision below, if allowed to stand, would nullify such Congressional intent by permitting the production of automobile parts from a combination of new materials with salvaged parts of worn-out articles having no other value than that of junk and the sale thereof in competition with similar automobile parts produced entirely from new materials, without being subjected to tax upon sale to the wholesale trade.

It should be remembered that the excise tax is a revenue measure exclusively. Thus, the facts must be considered in the light of such statutory object and purpose.

The tax is on each transaction at the rate of 2% of the manufacturer's sale price of the article sold. It is not imposed upon repair jobs involving mere contracts for labor and material on articles owned and used by another. Because of the hundreds of thousands of transactions occurring daily throughout the country, which are subject to the excise tax provisions, the method of ascertainment of such taxes must be possible of accomplishment without being fettered by technical refinements which tend to defeat the purpose of the statute as a means of raising revenue. The following quotation from *Raybestos-Manhattan Co. v. United States,* 296 U. S. 60, 63, is apropos here:

> The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements.

See, also, *Founders General Co. v. Hoey,* 300 U. S. 268, to the same effect.

In *Tyler v. United States,* 281 U. S. 497, the Court stated (p. 503):

> The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fictions * * *.
>
> Taxation, as it many times has been said, is eminently practical * * *.

In the *Tyler* case, the Court held that the Congressional intent to tax decedent's interest at date of death in a tenancy by the entireties could not be restricted by the technical incidents of such common law tenancy. Likewise, the terms "manufacturer" or "producer", used in the statute, should not be treated as words of art, but rather construed so as to effectuate the evident broad intent of Congress with respect to the taxation of automobile parts. In *Turner v. Quincy Market Cold Storage & Warehouse Co.,* 225 Fed. 41, 43 (C. C. A. 1st), it was held that the term manufacture "is a very broad word, which it is not safe to limit in a general way." See *Hughes & Co. v. City of Lexington,* 211 Ky. 596, 277 S. W. 981, 982, wherein the court, in holding that appellant was engaged in manufacturing, stated:

> That the definition of the term is a question of law and for the courts is plain, but the courts are practically agreed that it is incapable of exact definition, and that there is no hard and fast rule which can be applied, but that *each case must turn upon its own facts, having regard for the sense in which the term is used and the purpose to be accomplished.* [Citing cases.] (Italics supplied.)

In *Carbon Steel Co. v. Lewellyn,* 251 U. S. 501, it was held that the rule of strict construction will not be pressed so far as to reduce the taxing statute to a practical nullity by permitting easy evasion. The Court stated (p. 505):

> It is, of course, the contention of petitioner that this was furnishing, not *manufacturing,* and that the literal meaning of words can be insisted on in resistence to a taxing statute. We recognize the rule of construction but it cannot be carried to reduce the statute to empty declarations. And, as we have already said, petitioner's contention would so reduce it.

It may be added that the proper guide for the interpretation and construction of Section 606(c)—as for all internal revenue laws—was furnished by the Supreme Court in *Stone v. White,* 301 U. S. 532, 537:

> It is in the public interest that no one should be permitted to avoid his just share of the tax burden except by positive command of law, which is lacking here.

It follows from what has been said that the first question for determination in a case of this kind is whether there has been a *sale* of the articles under consideration, for if there has been no sale the statute does not apply. If the articles have been sold, the only remaining inquiry is whether the seller was also the manufacturer, producer, or importer thereof, within the meaning of the applicable statute and regulations. In passing upon the latter question, it should be borne in mind that the idea of one repairing an article for another is opposed to the idea that the repairer may be simultaneously the seller of the article itself upon completion of his contract for the performance of labor and supplying of materials. Yet, conversely, the taxpayer contends in substance, in its claim for refund, that although it was the seller of the articles in question, it should be held to be only the repairer thereof. There is no question but that the armatures were sold by appellee for use by ultimate vendees in repairing automobile engines.

II.

Appellee Is the Manufacturer or Producer of the Armex Automobile Generator Armature Sold by It and Not Merely a Repairer of Used, Damaged and Worn Out Armatures.

Appellee was incorporated "to carry on the business of manufacturing and assembling armatures * * *" and to market them. [R. 106.] It operated a plant, had considerable machinery and equipment, employed on an average 14 or 15 men, produced at least 80 armatures per day and maintained a stock for sale of 600 different types of armatures, each with appellee's own stock number.

The taxing statute does not discriminate between automobile parts produced entirely from new materials and those produced by combining new materials with usable materials salvaged from scrap or junk which has been purchased and dismantled for such purpose. Neither do the definitions of the words manufacturer, producer, manufacture, or produce, require that a manufactured article shall consist entirely of new or virgin raw materials. In fact, it has been held that a manufactured article need not be made wholly or even in part of raw material. *The King v. Biltrite Tire Co.,* 1937 Canada Law Rep. (Ex. C. R.) 1, 14.

Appellee considered itself the manufacturer or producer of the armatures it stocked and sold. Otherwise, it is not likely that it would have adopted the distinctive trade mark and trade name under which it advertised its product in its catalogs as one made and produced by it. It did not represent itself as a mere "repairer". In other words, it held itself out as the producer of the taxable articles which it processed and placed in marketable form. Cf. *Red Star Yeast & Products Co. v. LaBudde,* 83 F. (2d) 394, 396 (C. C. A. 7th).

Even in the absence of its representations, the evidence clearly shows that appellee was the manufacturer and producer of the armatures which it sold because the essential elements of manufacture were shown to exist. It made a serviceable and salable product from scrap and raw materials. It acquired, at a small price, worn-out armatures from which it salvaged the usable parts and then by machine and hand operations, together with the addition of new materials, it assembled and fashioned an automobile part which it marketed under its own trade name in competition with similar products manufactured by others. Whether the appellee itself manufactured the commutator, shaft and laminations used in producing "Armex" armatures would appear immaterial. The essential fact is that the appellee combined the salvaged individually useless items with new materials and, through the employment of skill, labor and machinery, produced a valuable item of commerce.

There can be no dispute but that when appellee acquired the worn-out armatures they were classifiable as scrap and junk. The following definitions and authorities concerning scrap and junk seem clearly applicable:

56 Corpus Juris 884-885, states:

> *Scrap.* (Sec. 1) A. *As Noun.* The word originally meant what was scraped off. It has come to have an extended meaning and includes anything that is thrown aside. The word has reference to the antecedent history of the article and not to the use that a new owner might make of it.
>
> * * * * * * * *
>
> (Sec. 2) B. *As Adjective.* On the form of scraps; also valuable only as raw material.

In *Ward, Ltd. v. Midland R. Co.,* 33 T. L. R. 4, 6 (Eng.), "scrap" was defined as follows:

> An article was scrap if it was no longer useful to its owner; the word had reference to the antecedent history of the article and not to the use that a new owner might make of it.

The word "junk" has been held to include discarded parts of machinery. *City of Duluth v. Bloom,* 55 Minn. 97, 100, 21 L. R. A. 689, 690. Discarded automobile fixtures were held to be within the definition of "junk" in *Melnick v. City of Atlanta,* 147 Ga. 525, 94 S. E. 1015. In *City of Chicago v. Reinschreiber,* 121 Ill. App. 114, 120, the court defined the word "junk" as (pp. 118-119)—

> worn out or discarded material in general, that still may be turned to some use, especially old rope, chain, iron, copper, parts of machinery, bottles, etc., gathered or bought up by persons called "junk dealers" * * *.

In the instant case the used armatures were nothing more than "junk" when received by appellee. The principal purpose of its business was to produce and sell armatures for numerous makes of automobiles from raw and essentially raw material which it prepared. The acquisition of second-hand material was merely incidental to its manufacturing business.

In *City of Louisville v. Zinmeister & Sons,* 188 Ky. 570, 222 S. W. 958, the court stated (pp. 575-576):

> Courts have experienced much difficulty in determining what is a manufacturing establishment and what is included in the term "manufacture." There is no hard and fast rule by which to determine whether a given establishment is a "manufactory," but *all the*

> *facts and circumstances must be taken into consideration* in determining whether the establishment is or is not to be so reckoned. *Whether it is such an establishment does not depend upon the size of the plant, the number of men employed, the nature of the business or the article to be manufactured, but upon all these together and upon the result accomplished.*
>
> If raw material is converted at a factory or plant into a finished product, complete and ready for the final use for which it is intended, or so completed as that in the ordinary course of business of the concern it is ready to be put upon the open market for sale to any person wishing to buy it, the plant which turns it out is a manufacturing establishment within the meaning of the statutes * * *. (Italics supplied.)

Likewise in the instant case it is important to consider all the surrounding facts and circumstances and not limit consideration of the question involved to any single factor, or to the narrow confines of an antiquated literal interpretation of the word "manufacture" as understood prior to the advent of modern machinery and industrial methods of salvaging for manufacturing purposes.

If the terms "manufacturer" and "producer" are to be whittled away by fine distinctions, the intent and purpose of Congress to impose a tax upon automobile parts produced and sold to jobbers and wholesalers will necessarily be defeated. *In re First Nat. Bank,* 152 Fed. 64, 67 (C. C. A. 8th).

It cannot be disputed that the used armatures, or scrap, had lost their commercial value as armatures. When purchased and acquired by appellee they were valuable to it merely for the purpose of obtaining the usable shafts,

commutators and metal laminations for use by it as partially prepared raw materials to which, after preparation thereof for its operations, it added other raw materials, skill and industry before there was completed and created the marketable product which it placed in stock for sale to its jobber trade. Such salvaged prepared materials, consisting of usable shafts, commutators and metal laminations, were not armatures while in that form but, as stated, constituted partially prepared materials on which appellee thereafter performed hand and machine operations, added other materials, assembled the same and employed skill before the salable article was completed for marketing. The position of appellee is the same as if it had purchased shafts, commutators and metal laminations salvaged (from discarded and worn-out armatures) and prepared by the vendor for combination with the new materials in connection with assembling and finishing operations. If then appellee had purchased from a third party the remaining necessary materials, consisting of black enameled cotton insulated cooper wire, solder, flux, varnish, end fibers, slot insulations, slot wooden wedges, crepe, armature twine or cord, etc., and continued with all subsequent steps, it could hardly be suggested that the article in its final condition had not been produced or manufactured by appellee. The mere fact that appellee has itself performed the defined operations on the salvaged parts of the used armatures cannot exclude it from operation of the taxing statute.

The court below was of the opinion that the old or worn-out armature did not lose its identity *qua* armature and that, therefore, the appellee could not be said to have manufactured or produced an armature. However, when one bears in mind the various steps taken by appellee, and particularly the state of the article when reduced to the

three salvaged usable parts (shaft, commutator and steel laminations), it would appear that appellee cannot be any less the manufacturer of an armature because it started with something that had once been a usable armature than if, as suggested above, it had commenced with several substances purchased from different sources.

We think that all of taxpayer's contentions have been thoroughly discussed and answered by seven able Canadian judges in the re-treaded tire decisions of *Biltrite Tire Co. v. The King,* 1937 Canada Law Rep. 364; *The King v. Biltrite Tire Co.,* 1937 Canada Law Rep. 1, and *The King v. Boultbee Ltd.* [1938], 3 Dominion Law Rep. 664.

The foregoing Canadian decisions carry the full burden of our argument and effectively refute any contentions of appellee.

With the exception of the instant case and one other (*Con-Rod Exchange, Inc. v. Henricksen,* 28 F. Supp. 924 (W. D., Wash.)), virtually all the recent cases involving facts and questions similar to those presented here have been decided in favor of the Government, including the only case which has gone to an appellate court, *viz., Clawson & Bals v. Harrison,* 108 F. (2d) 991 (C. C. A. 7th) involving "rebabbitted" connecting rods; *E. Edelman & Co. v. Harrison* (N. D., Ill.), decided April 7, 1939, not officially reported but published in 1939 Prentice-Hall, Vol. 1, par. 5,379 (armatures); *Federal-Mogul Corporation v. Smith* (S. D., Ind.), decided February 23, 1940, not yet reported but published in 1940 Prentice Hall, Vol. 4, par. 62,510 (connecting rods); *Moore Bros., Inc. v. United States* (N. D., Tex.), decided May 14, 1940, not officially reported but published in 1940 Prentice-Hall, Vol. 4, par. 62,676 (armatures).

It is true that there have been a number of District Court decisions against the Government involving so-called "rebuilt" armatures and generators, "rebabbitted" connecting rods and "re-treaded" tires. *Monteith Bros. Co. v. United States* (N. D., Ind.), decided October, 1936, not officially reported but published in 1936 Prentice-Hall, Vol. 1, par. 1710 (involving armatures and connecting rods); *Hempy-Cooper Mfg. Co. v. United States* (W. D., Mo.), decided May 6, 1937, not officially reported but published in 1937 Prentice-Hall, Vol. 1, par. 1461 (connecting rods); *Bardet v. United States* (N. D., Cal.), decided May 18, 1938, not officially reported but published in 1938 Prentice-Hall, Vol. 1, par. 5,507 (connecting rods); *Becker-Florence Co. v. United States* (W. D., Mo.), decided December 27, 1938, not officially reported but published in 1939 Prentice-Hall, Vol. 1, par. 5,161 (armatures); *Con-Rod Exchange, Inc. v. Henricksen,* 28 F. Supp. 924 (W. D., Wash.) (connecting rods), and *Skinner v. United States,* 8 F. Supp. 999 (S. D., Ohio), (tires). However, these cases did not present satisfactory records for appeal.

We submit that the principles laid down in the *Clawson & Bals* case, *supra,* are squarely in point here. The Circuit Court of Appeals in that case stated as follows (pp. 992-993):

> In the course of announcing its decision the District Court made the following statement:
>
> "The court is of the opinion that what the plaintiff did and what it is doing is the manufacturing and producing of connecting rods from scrap. It is true that the scrap may have slightly greater value than some other kinds of scrap, but it is still scrap, and when it is manufactured or produced by the plaintiff

it has a relatively much greater value than in its scrap condition.

"The situation here seems to be much like the situation in the worn-out tire case. Those worn-out tires look like tires. These worn-out connecting rods undoubtedly look like connecting rods, and one can recognize that they have been connecting rods, just as one can by looking at a worn-out tire recognize the fact that it has been a tire. But in each case, the articles are worn out. A manufacturing process is, in the opinion of the court, required to make a serviceable product; and in the case of the connecting rod, the plaintiff carries on that manufacturing process."

We believe that the foregoing aptly sums up the merits of the case.

As we also strongly rely on the Canadian decisions, *supra,* the following is again quoted from the *Clawson & Bals* decision (pp. 993-994):

Defendant-appellee cites and relies strongly upon a decision of the Supreme Court of Canada in *Biltrite Tire Co. v. The King.*[2] The analysis of the facts and the reasoning of the court as revealed in the opinion are strongly persuasive that on the facts of the instant case the taxpayer is a manufacturer or producer of connecting rods. The legislative enactment imposed an excise duty on "tires in whole or in part of rubber" which were "manufactured or produced in Canada and sold." The business practice of the Canadian taxpayer was to purchase in bulk lots old and worn-out motor vehicle tires and put them through a process of repair, treatment and retreading, for sale

[2]1937 Canada Law Rep. 364.

in the trade. Throughout the process the sidewall of the tire was not dismantled or destroyed, the numerical identification of the original tire was not destroyed, and the name of the manufacturer of the original tire was clearly marked upon its sidewalls, upon which the taxpayer also marked a serial number. In the course of treatment of the old tire the tread was removed and a new tread affixed; holes were patched, cement and plastic rubber preparation utilized. The final result of the treatment was that repairs to holes and blow-outs, the cementing inside and without, and the new tread, were firmly and permanently affixed to the fabric and side-walls of the original tire. The Canadian court sums up the whole process as follows:

"What the appellant did was to remove part of the old or worn-out tire and add to the remnant the plastic rubber preparation. It would appear that the position is the same as if the appellant had purchased an old or worn-out tire which had already been treated by the vendor in the manner described above, down to and including the cutting off of the old tread. If then the appellant had purchased from a third party the rubber preparation and had applied the latter and continued with the subsequent steps, could it be suggested that the article in its final condition had not been produced or manufactured by the appellant. The definitions of words 'manufacture' and 'produce' as nouns or verbs, in the standard dictionaries, clearly indicate that such proceedings would constitute the appellant a manufacturer or producer. And the mere fact that the appellant has itself performed the defined operations on the old tire cannot exclude it from the operation of the section.

"* * * It is suggested that the old or worn-out tire did not lose its identity *qua* tire and that, there-

> fore, the appellant could not be said to have manufactured or produced a tire. However, when one bears in mind the various steps taken by appellant and particularly the state of the article when the tread was removed, it would appear that appellant cannot be any less the manufacturer of a tire because it started with something that had once been a usable tire than if, as suggested in the preceding paragraph, it had commenced with two substances purchased from different sources."

The cases chiefly relied upon by the court below in its opinion are *Hartranft v. Wiegmann,* 121 U. S. 604; *Anheuser-Busch Assn. v. United States,* 207 U. S. 556; *Fruit Growers, Inc. v. Borgdex,* 283 U. S. 1, and the several District Court cases referred to above involving automobile parts. As stated, the conclusions reached in the several District Court cases are inapplicable under the evidence in this case, are erroneous and conflict with the principles announced in *Clawson & Bals, supra.* Neither do the Supreme Court decisions relied upon by the court below in its opinion support its judgment or require a conclusion contrary to that contended for by appellant. They arose under provisions of the tariff and patent laws and the Supreme Court's reasoning was addressed to fact situations entirely unrelated to that presented here. A proper appraisal of the excerpts thereof from the opinion below can be made only by considering the entirely different fact situations to which the Supreme Court's statements and reasoning were directed.

Thus, in *Hartranft v. Wiegmann, supra,* the question was whether the cleaning and, in some instances, etching and polishing of crude sea shells by London merchants for sale as shells for purpose of ornament, caused the shells,

upon importation into the United States, to fall within the duty free class of "shells of every description, not manufactured," or within the dutiable provision of "Shells, manufacturers of:". The Supreme Court held they were to be admitted free because they were still shells, and were not manufactured within the sense of the tariff statute. The shells were products of nature which were merely beautified for purpose of sale as ornamental shells. There was no salvaging of worn-out, unserviceable materials or parts which had been discarded as no longer useful for the purpose to which originally put and adapted. Substantially the same situation existed in *Anheuser-Busch Brewing Assn. v. United States, supra.* The Association imported corks already manufactured and merely gave the manufactured articles special treatment for its own special purposes, that is, for use in the encasement of its beer. Similarly, in *Fruit Growers, Inc. v. Borgdex, supra,* the Supreme Court held that the immersion of oranges in a solution to prevent decay while on the road to market was not a manufacturing process and did not result in a manufactured article. The orange was an edible fruit both before and after the process.

In *Cadwalader v. Jessup & Moore,* 149 U. S. 350, the recovery of customs duties was sought on the ground that old india-rubber shoes imported by Jessup & Moore were valuable only as a substitute for crude rubber and, therefore, were exempt from duty under the free classification "India-rubber, crude and milk of." A duty of twenty-five per cent *ad valorem* had been collected on the old shoes as (p. 351) "articles composed of india-rubber, not specially

enumerated or provided for in this act." Another section of the act provided for a duty on non-enumerated articles equal to that imposed upon the enumerated articles they most nearly resembled, and where they resembled two or more enumerated articles, that taking the highest duty was to be used as the basis. The Supreme Court, in holding the articles to be non-dutiable, held that the old shoes had lost their commercial value as such articles, and substantially were merely the material called "crude rubber". Thus, the principle of the *Cadwalader* case supports the contention that appellee was a manufacturer and producer since here, because of the loss of their commercial value, the armatures were essentially raw material.

In passing, attention is directed to the fact that the principles of the *Clawson & Bals* case, *supra,* have been adopted and are being followed by the Treasury Department, as shown by Sales Tax Ruling 896, 1940-8 Int. Rev. Bull. 19.

In conclusion, therefore, it may be said that when looked at from the standpoint of production and distribution in the trade the appellee is and was performing the function of a manufacturer and producer rather than a repairer. Appellee produced armatures for the trade in the very true sense and did not repair, rebuild, restore or rewind old or used armatures for owners or users. The fact that appellee could perhaps perform for the owner of used and worn-out armatures all of the mechanical operations which it may have performed for itself, and still properly be classified as a repairer or rebuilder, does not

require a holding that the appellee is a repairer or rewinder when it purchases discarded armatures to be used as materials for combination with other materials of the appellee, and by mechanical operations prepares what are, for all practical purposes, new armatures for sale in the trade.

We submit that the decisions of the seven Canadian judges and of the Seventh Circuit Court of Appeals afford a correct basis for the interpretation of the provisions of the taxing statute and applicable regulations, and any other conclusion is erroneous.

Conclusion.

It is submitted that the evidence does not support the alternate findings, conclusions and judgment below, and it should be reversed.

Respectfully submitted,

SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
NORMAN D. KELLER,
GEO. H. ZEUTZIUS,
CARL PERGLER,
Special Assistants to the Attorney General.

BEN HARRISON,
United States Attorney.
E. H. MITCHELL,
Assistant United States Attorney.
ARMOND MONROE JEWELL,
Assistant United States Attorney.

June, 1940.

APPENDIX.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 606. TAX ON AUTOMOBILES, ETC.

There is hereby imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

* * * * * * * *

(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsection (a) or (b), 2 per centum. * * *

[Note: Subsections (a) and (b) refer to autobiles, automobile trucks and motorcycles.]

Treasury Regulations 46, approved June 18, 1932:

ART. 4. *Who is a manufacturer or producer.*— As used in the Act, the term "producer" includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.

Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

A manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, shall be liable for the tax under Title IV and not the person who buys and assembles a taxable article from such component parts.

ART. 41. *Definition of parts or accessories.*—The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

The term "parts and accessories" shall be understood to embrace all such parts and accessories as have reached such a stage of manufacture that they constitute articles commonly or commercially known as parts and accessories regardless of the fact that fitting operations may be required in connection with installation. The term shall not be understood to embrace raw materials used in the manufacture of such articles.

Spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, automobile truck or other automobile chassis or motorcycles, are considered parts or accessories for such articles whether or not primarily designed or adopted for such use.